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Diet Concludes Session

The 102nd regular session of the Diet ended June 25, concluding a 150-day session in which legislators approved most of the major bills introduced by the cabinet, but failed to address several key issues that are fundamental pillars of the Nakasone government. Among the issues neglected were educational reform, reorganization of the Japanese National Railways (JNR) and redistribution of seats in the lower house of the Diet.

As usual, almost all of the bills formally introduced in this session were approved. Unlike Congress, where tens of thousands of bills and

committed to a steady defense buildup compatible with its overall presence in the region.

Preliminary sparring over the FY 1986 defense budget followed notification by the Foreign Ministry to the Diet that for the first time the United States had formally requested a transfer of military technology from Japan under the terms of notes exchanged between the two countries in November 1983. The request is said to be related to "image homing" guidance technology for use in tactical missiles. "Image homing" systems enable missiles and "smart" bombs to neutralize decoys that are effective on heat-sensitive and other systems by enabling the missile to "memorize" the physical characteristics of a target. Under the terms of the 1983 agreement, the ad hoc committee on technology transfers, consisting of representatives from both the United States and Japan, must review the request before the transfer is approved.

Michael W. Chinworth

Surging Capital Outflow Puts Japan Near Top Creditor Position

Preliminary data from the Ministry of Finance (MOF) reveal that Japanese investors sent a tidal wave of money out of the country in 1984, much of it going to the United States and European countries. A net long-term capital outflow of \$49.7 billion was recorded last year, pushing Japan's net overseas assets to \$74.3 billion. In contrast, the United States saw its net foreign assets erased by March 1985, a decline of more than \$100 billion in a little over a year. MOF points to the record increase in Japan's 1984 current account surplus (\$35 billion) as the largest factor in the rapid accumulation of foreign assets.

Japan's net capital outflows to the United States and the European Community (EC) highlight the sharp change in its international financial position (see Table 1). The total net outflow of long-term capital jumped 2.8 times in 1984, with net flows to the United States rising 2.7 times and those to the EC 3.9 times. While overall portfolio investment more than tripled between 1983 and 1984, such investments in the EC were 38 times higher in 1984 and in the United States 2.7 times bigger. The leap in investment going into the EC reflects MOF's opening of the Euroyen market to Japanese companies and financial institutions.

It is interesting to note last year's pattern of investment in Europe versus that in the United States. The United States attracted the majority of Japan's direct investment and a little less than half of the portfolio investment. The EC, on the other hand, played a small role in Japan's direct investment but an increasingly important one in its portfolio investment.

Japan's external assets totaled \$341.2 billion at the end of 1984 and liabilities rose to \$266.9 billion (see Table 2), yielding a net \$74.3 billion. This placed Japan ahead of the United States and West Germany but after Great Britain in terms of net external assets. The private sector was clearly the major actor in this drama, as private investors added \$53.9 billion in foreign long-term assets while taking on just \$7.2 billion in corresponding

liabilities. Loans and portfolio investment accounted for nearly all of this increase, a situation with strong implications for the country's future balance of payments. Up until this spring, Japan ran a deficit in terms of international investment income. Heavy purchases of U.S. government securities, which show an immediate return, pushed the invisibles balance into the black for the first time in April 1985 -- a trend that is likely to persist and accelerate.

Table 1: Net Outflow of Japanese Long-Term Capital

(in billions of dollars)

	<u>1983</u>	<u>1984</u>
Portfolio Investment - Overall	\$7.5	\$23.6
To the United States	3.9	10.6
To the EC	0.2	7.6
Direct Investment - Overall	3.2	6.0
To the United States	1.0	3.2
To the EC	0.5	0.7
Loans - Overall	8.5	12.0
To the United States	0.3	0.5
To the EC	1.5	1.6
Long-Term Capital Balance - Overall	17.7	49.7
With the United States	5.5	14.8
With the EC	2.8	10.9

Source: Ministry of Finance

MOF officials predict that Japan will push its net assets above \$100 billion by the end of 1985, making it the world's largest creditor nation. The implications of Japan's surplus, as well as the United States' deficit, are just beginning to be discussed.

Jon Choy

International Trade White Paper Released

The Ministry of International Trade and Industry (MITI) recently released its annual White Paper on International Trade. The 421-page report analyzes the state of the world economy in 1984 and Japan's trade and payments balances. Echoing many of the themes that Prime Minister Yasuhiro Nakasone has expressed in recent addresses, the paper urges an increase in imports (particularly of manufactured products), an expansion of domestic demand in order to reduce Japan's mounting trade surplus, and an early start for a new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT). The report also proposes that Japan take a leading role in developing the base for a new international trading system.

Table 2: Japan's External Assets and Liabilities, 1983-84

(in millions of dollars)

<u>Assets</u>	<u>1983</u>	<u>1984</u>	<u>Change</u>
Long-Term Assets	\$170,905	\$229,184	\$58,279
Private sector	138,051	191,946	53,895
Direct investment	32,178	37,921	5,743
Export credit	18,110	22,824	4,714
Loans	29,266	40,601	11,335
Portfolio investment	56,115	87,578	31,463
Other	2,382	3,022	640
Government sector	32,854	37,238	4,384
Export credit	1,165	1,189	24
Loans	22,473	24,491	2,018
Other	9,216	11,558	2,342
Short-Term Assets	101,051	112,024	10,973
Private sector	75,492	84,761	9,269
Financial accounts	72,087	77,562	5,475
Other	3,405	7,199	3,794
Government sector	25,559	27,263	1,704
Financial accounts	25,556	27,261	1,705
Other	3	2	(1)
Total Assets	271,956	341,208	69,252
<u>Liabilities</u>	<u>1983</u>	<u>1984</u>	<u>Change</u>
Long-Term Liabilities	\$102,794	\$113,222	\$10,428
Private sector	76,551	83,738	7,187
Direct investment	4,364	4,458	94
Import credit	16	24	8
Loans	1,320	1,266	(54)
Portfolio investment	69,948	77,081	7,133
Other	903	909	6
Government sector	26,243	29,484	3,241
Loans	124	103	(21)
Portfolio investment	26,119	29,381	3,262
Other	0	0	0
Short-Term Liabilities	131,903	153,640	21,737
Private sector	125,064	145,900	20,836
Financial accounts	107,308	130,098	22,790
Other	17,756	15,082	(1,954)
Government sector	6,839	7,740	901
Financial accounts	3,765	3,590	(175)
Other	3,074	4,150	1,076
Total Liabilities	234,697	266,862	32,165

Source: Ministry of Finance

The white paper's examination of the world economic scene focuses on the rapid recovery of international trade and the rising volume of global exports. According to the report, the increase is mainly attributable to the U.S. economic recovery, the soaring dollar and the consequent large flow of imports into the United States and Canada. Japan's exports rose almost 16 percent to approximately \$170 billion, \$60 billion of which went to the United States in the form of cars, computer peripheral equipment, video cassette recorders and other manufactured goods.

On the other side of the trade ledger, Japan's aggregate imports increased by 10 percent. Imports of manufactured goods rose 18.2 percent in 1984 to more than \$40 billion, thus accounting for almost 30 percent of total imports. Purchases of consumer goods, however, represented a disappointing 16 percent of total imports. The white paper acknowledges that Japanese corporations will have to increase efforts to purchase foreign manufactured goods in order to break this trend.

In the short term, the only means suggested for expanding domestic demand for imports are to bring down the value of the dollar and encourage foreign exporters to develop products to fit the Japanese market. The report also affirms that expanded foreign direct investment and technology transfer are the long-term solutions for relieving the tensions caused by Japan's large trade surpluses with most nations. These surpluses are attributed by the report to the strong U.S. dollar, the decline in the international market price of petroleum and other primary goods and the admittedly competitive and healthy Japanese private sector.

The white paper has been produced annually by MITI to update members of the Japanese cabinet and the public about the state of the international marketplace and Japan's position in it. As one newspaper editorialized, it is "disturbing reading for any person who is worried about the irritations of the nation's trading partners" since its recommendations offer no new solutions to the problems engendered by Japan's export-oriented trade structure. In fact, the conclusions of the document are almost identical to those presented in last year's volume.

Sheri Hoptman

Japan's Telecommunications Market Heats Up

The pace of agreements among Japanese and U.S. telecommunications firms has accelerated sharply since the April 1, 1985 liberalization of Japan's telecommunications market. A number of corporations have applied to the Ministry of Posts and Telecommunications (MPT) for operating licenses as common carriers (Type I companies) and providers of enhanced data transmission services (Type IIs). The newly privatized Nippon Telegraph and Telephone Corp. (NTT), previously the sole provider of primary voice communications, will face at least five competitors by 1988. Competition in the Type II market centers around value-added networks (VANs), with foreign and domestic companies offering a multitude of local and nationwide systems. Although the market will take several years to mature, the private sector's initial response to the reforms has been enthusiastic.

American Telephone & Telegraph Co. (AT&T) chairman Charles L. Brown flew to Japan last week to announce AT&T's pact with Japan ENS Corp. to offer a large-scale VAN to Japanese customers. The service will encompass the processing, storing and transmission of data on a global basis, not just nationwide. Japan ENS plans an intelligent network to link most types of computers and data protocols, drawing on AT&T's experience in the United States with its Net 1000 system. Japan ENS will contribute marketing and after-sales support efforts, key aspects of AT&T's penetration of the Japanese market. The joint venture will be a major force in the market, not only because of AT&T's size but because Japan ENS is composed of 16 major Japanese corporations, including the Bank of Japan, Ltd., Mitsui & Co., Ltd., Hitachi, Ltd. and Fujitsu, Ltd. AT&T will provide half of Japan ENS' ¥10 billion (\$400 million) capital by October, as well as have employees in managerial and technical positions. The agreement puts AT&T into direct competition with NTT, IBM Japan Ltd., NEC Corp. and other electronics giants in the large-scale VAN market.

The Ministry of Posts and Telecommunications in late June approved the applications of five Japanese firms to compete directly with NTT in the common carrier market (see table). The first three rivals plan to begin operations by late 1986 in the heavily populated Tokyo-Osaka corridor, and the remaining two will offer nationwide service by early 1988. Two of the new Type I firms are particularly interesting in light of their government connections: Japan Telecom Co., Ltd. is backed by the Japanese National Railways, while Teleway Japan Corp. is the brainchild of the Japan Highway Public Corp. and, indirectly, the Ministry of Transportation.

Equally interesting are the means of transmission selected by each new firm. Japan Telecom and Teleway Japan, drawing on the substantial real estate holdings of their backers, plan to lay fiber-optic networks. Daini-Denden Inc., lacking such support, chose the aerial route: a network of microwave towers. Although these three firms are potential customers for American telecommunications equipment makers, the remaining two firms are the most promising targets because of their choice of a satellite system as the means of transmission. Hughes Communications Inc. has a 30 percent stake in Japan Communications Satellite Co., Ltd., while Ford Aerospace and Communications Corp. has links with Space Communications Corp.

Even though Japan's international telecommunications market was not explicitly included in the reform legislation, MPT has said that it expects the spirit of free competition to extend to Kokusai Denshin Denwa Co., Ltd. (KDD), the quasi-government corporation that dominates Japan's international telecommunications links. Prior to liberalization, KDD agreed to lease its international circuits to General Electric Information Service Co., GTE Telenet Inc. and McDonnell Douglas Corp.'s Tymnet Inc. for their international VAN systems. KDD, AT&T and others are also planning a trans-Pacific fiber-optic cable with eight times the capacity of existing undersea links, scheduled for completion in 1987. Of greater significance is KDD's recent decision to tie up with MCI Communications Corp.'s U.S. telephone network to provide trans-Pacific voice communications services. Only AT&T has a similar agreement with KDD. Furthermore, the recent decision by International Business Machines Corp. (IBM) to sell MCI its stake in Satellite Business Systems, a private satellite communications company, in exchange for MCI stock means that the intense AT&T-IBM rivalry will be extended across the Pacific.

Japan's New Common Carriers

	<u>Capital</u> (Y billion)	<u>Major</u> <u>Shareholders</u>	<u>Services</u>	<u>Service</u> <u>Areas</u>	<u>Start of</u> <u>Operations</u>	<u>Equipment</u>	<u>Number of</u> <u>Circuits</u>
Daini-Denden Inc.	Y8.0	Kyocera Corp., 28% Ushio Inc., 2.5%	Telephones and leased circuits	Tokyo-Osaka	Leased circuits December 1986 Telephones October 1987	Microwave	5,760
Japan Telecom Co., Ltd.	8.4	JNR, 36% Nippon Express Co., Ltd., 1.2%	Telephones and leased circuits	Tokyo-Osaka; parallel to bullet trains	Leased circuits October 1986 Telephones October 1987	Fiber-optic	4,320
Teleway Japan Corp.	8.3	Toyota Motor Corp., 6%	Telephones and leased circuits	Tokyo-Osaka; parallel to major highways	Leased circuits November 1986 Telephones September 1987	Fiber-optic	5,760
Japan Commu- nications Satellite Co., Ltd.	0.4	C. Itoh & Co., Ltd., 40% Mitsui & Co., Ltd., 30%	Leased circuits	Nationwide	February 1988	Satellite	
Space Commu- nications Corp.	0.1	Mitsubishi Corp., 75% Mitsubishi Electric Corp., 25%	Leased circuits	Nationwide	April 1988	Satellite	

Even though Tokyo has liberalized Japan's telecommunications markets, the government will continue to be heavily involved in promoting the domestic industry. MPT and a local Kansai business group have announced plans to open a telecommunications research laboratory near Kyoto by March 1986. Possible projects include a laser-based satellite communications system, optical transmission and processing systems and a telephone with a built-in translator. Nevertheless, market opportunities in Japan have been greatly improved, and foreign and domestic companies are moving aggressively to exploit them.

Jon Choy

Export Administration Act Approved By Congress

After two years in limbo the Export Administration Act (EAA) will become law. Both the Senate and the House approved the bill by voice vote June 27 after a conference committee reached quick agreement on final details in a meeting two days earlier. The measure, which replaces the version of the EAA that expired in March 1984, outlines the administration of a number of export controls and procedures.

With strong support from the Reagan administration and the determination to avoid the controversies that prevented passage of the measure last year, bill managers had placed the current session's version of the EAA on a "fast track" for consideration. After prompt attention in committee review, Senate approval was gained April 3, followed by House passage of a slightly amended version April 16. When the necessity of a conference to reconcile the different versions of the bill became apparent in early May, some observers feared a repeat of the long -- and eventually inconclusive -- debate of last summer since most of the same participants from that round were again appointed to the conference committee (see JEI Report No. 44A, November 16, 1984). Instead, the negotiating process was left to key staff members, and action on EAA went underground for nearly two months.

The contentious issues mainly concerned the roles of the Defense Department, Justice Department, Commerce Department and U.S. Customs Service in enforcing the legislation. Provisions to substantially expand the powers of the Secretary of Defense to control exports for national security reasons were dropped. The Pentagon's control over high technology exports to Soviet bloc countries will remain basically unchanged from previous years -- a hard-won, if limited, concession to members of the business community who argued for less government interference in exports to communist countries.

The House and Senate versions had also differed on what roles the Commerce Department and the Customs Service would play in enforcing provisions of the EAA. The conference compromise was to let the two organizations share enforcement responsibility. A proposal by Rep. Peter Rodino (D, N.J.) giving the Justice Department authority to write regulations for Commerce and the Customs Service was modified during the conference session. Justice will be able only to offer guidelines for enforcement -- and that only to the Commerce Department.